FINAL ACCESS DETERMINATION: THE DOMESTIC MOBILE TERMINATING ACCESS SERVICE

PRIMARY PRICES

Response to the
Australian Competition and
Consumer Commission's Discussion Paper

September 2014

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1. Introduction

Vodafone Hutchison Australia Pty Limited (**VHA**) welcomes the opportunity to participate in the ACCC's consultation on its final access determination (**FAD**) discussion paper for primary prices for the Domestic Mobile Terminating Access Service (**MTAS**) (**Discussion Paper**). The Discussion Paper presents an opportunity for the ACCC to finally address the key issues that have beset the regulation of MTAS virtually since its inception, including lack of fixed to mobile (**FTM**) pass through and the use of a flawed pricing methodology.

A crucial starting point for the ACCC must be an assessment of whether the 2011 MTAS FAD decision has had the effect of promoting the long-term interests of end-users (**LTIE**). In the mobile services industry, revenue has declined for the second and third players in the market and the concentration of subscribers and profits within the industry has increased. In fixed line services, Telstra maintains a dominant position in the supply of fixed voice services and the imputed margin on fixed-to-mobile voice calls remains at very high levels. It would be inappropriate for the ACCC to further reduce MTAS pricing for voice services without providing robust evidence that the 2011 MTAS FAD decision caused consumer welfare to increase in the supply of both mobile services and fixed line services. This consumer welfare analysis is necessary to demonstrate that past MTAS pricing decisions have promoted the LTIE.

An important part of any LTIE assessment must be determining whether MTAS price reductions have benefited consumers. There is clear evidence that this is not the case. The following table shows a selection of Telstra's residential fixed line plans from 2003[1] and 2014.[2] It is clear that end-users have not adequately benefited from past MTAS price reductions in the form of lower off-net fixed-to-mobile (**FTM**) pricing. Whatever price reductions have occurred (and this is minimal) has been taken away from consumers via substantial line rental price increases.

[1] Telstra (2003), *A handy guide to home communications* (see Attachment A).

[2] Telstra (2014), 'Home phone plans', https://www.telstra.com.au/home-phone/plans-rates/index.htm#get, September.

2003	2014
Homeline Budget • Line rental: $17.50 a month, • Flagfall per call: 33 cents • Non-Telstra mobile price per minute: 42 cents/min • Price of a two minute call to Vodafone or Optus: **$1.17**	**Telstra Voice Budget** • Line rental: $23.95 a month • Flagfall per call: 49 cents • Non-Telstra mobile price per minute: 36 cents/min • Price of a two minute call to Vodafone or Optus: **$1.21**
Homeline Complete: • Line rental: $21.90 a month • Flagfall per call: 33 cents • Non-Telstra mobile price per minute: 37 cents/min • Price of a two minute call to Vodafone or Optus: **$1.07**	**Telstra Home Phone Local** • Line rental: $40 a month, • Flagfall per call: 49 cents* • Non-Telstra mobile price per minute: 30 cents/min* • Price of a two minute call to Vodafone or Optus: **$1.09**
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* Capped at $2 for the first 20 minutes per call.

Between 2003 and 2014, MTAS prices have fallen from over 21 cents per minute (**cpm**) to 3.6 cpm. It is clear that consumers have not adequately benefited from fixed to mobile price reductions. It is true Telstra has introduced Telstra Home Phone Pinnacle which does offer unlimited fixed to mobile calls. However, this plan costs $85 per month! We calculate the increased margin on retail FTM calls has contributed to Telstra accruing $1.4 billion in unrealised consumer benefits from the lack of retail FTM pass-through.

Unequivocally, the major beneficiary from lack of (or delayed) FTM pass through is Telstra due to its still dominant share of fixed voice subscriptions. By contrast, MTAS reductions have disproportionately adverse impacts on Telstra's competitors in the mobile services market – again an outcome that benefits Telstra and is detrimental to the LTIE. In 2011, Frontier Economics observed that "it is possible that the only beneficiaries of reductions in the price of the MTAS have been FNOs [Fixed Network Operators], of which Telstra would be the most significant".[3]

VHA notes the ACCC's assessment suggesting a higher level of pass through than our calculations.[4] VHA believes it would be worthwhile for there to be a transparent industry assessment of the ACCC's data and methodology. VHA would like to understand how the high subscription charge (and the other subscription prices) is included in the ACCC's FTM price calculations. The spurious correlations the ACCC have used in its Discussion Paper to suggest past MTAS reductions have promoted the LTIE do not meet the basic standards for evidence commonly used in other legal or regulatory processes.

Further, the ACCC's analysis misrepresents the fundamental challenge in regulating the MTAS, any lack of retail fixed-to-mobile pass through (FTM pass through) of past MTAS reductions to fixed line consumers, indeed any delay in FTM pass through, creates a dynamic efficiency problem. According to the ACCC's own reporting Telstra's FTM margins have increased from 37% at the end of 2004 to 64% in the third quarter of 2013.[5] Any decision that delivers significant benefits to an extremely profitable incumbent (even if they are transitory) must be carefully assessed. In our view, this is not an appropriate time to further enrich Telstra.

By contrast, mobile-to-mobile (MTM) traffic is relatively balanced between MNOs. For this reason, we regard MTM termination as having different underlying market dynamics to FTM termination. In principle, we accept that a lower price for MTM MTAS is appropriate. Despite this, we observe that in most markets (including Australia) a uniform termination charge is set for FTM and MTM services. This is because the potential for arbitrage discourages MNOs from pursuing differentiated access charging for FTM and MTM services. The ACCC may want to consider this matter as part of its review because, if the arbitrage opportunities can be avoided, price reductions for MTM termination may well be warranted.

The ACCC requires a quantitative economic framework to make an informed decision about the trade-off it faces in making its MTAS decision between enhancing incumbent fixed profitability and fostering a competitive mobile services market. In the absence of a coherent economic framework it is virtually impossible for the ACCC to assess whether its decisions are successfully meeting the statutory criteria and, as a consequence, to adjust its process where decisions have not had their anticipated effect. For instance, the ACCC has previously recognised that the

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[3] Frontier Economics (2011), *Welfare analysis of reduced mobile termination rates*, Prepared for VHA, July.

[4] ACCC (2014), *Public Inquiry into Final Access Determinations for Fixed Line Services – Primary Price Terms Discussion Paper'*, July, p22.

[5] ACCC, *Imputation testing and non-price terms and conditions report*, various years.

lack of retail fixed-to-mobile pass through had not met expectations,[6] yet in its most recent Discussion Paper the ACCC appears to have made a pre-judgment that it will not properly address the issue, ignoring a key component of access pricing – that is, Telstra's persistently high fixed voice margins.

Furthermore, to justify any change to MTAS charges, the ACCC must develop a cost model. This is the only means of conducting a thorough and scientific analysis of the cost of supplying the MTAS. VHA agrees with the ACCC's assessment that the WIK Model is "*no longer an appropriate means of estimating the costs of providing mobile termination services*".[7] For the reasons set out in this submission, the building block model should be used. This assessment is being undertaken in the fixed services review, it is appropriate it is also undertaken for MTAS.

VHA maintains that it was not in the long-term interest of end users (**LTIE**) to declare SMS for the reasons set out in its earlier submissions. Given that there have been clear signs of dynamic competition in SMS retail pricing, and infinite SMS inclusions for Vodafone's prepaid cap recharges from a $30 price point, VHA does not consider prices should be set for these services in the FAD. Instead, the ACCC should leave a window for commercial negotiation of termination prices. However, should the ACCC decide to set a regulated price for SMS termination services, it can only do so after developing a cost model which allows the ACCC to conduct a thorough and scientific analysis of the cost of supplying SMS termination.

[6] ACCC, *'Domestic Mobile Terminating Access Services Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011'*, March 2009, page 22

[7] Discussion Paper, page 12

2. FTM pass through and the LTIE

2.1 FTM pass through and the LTIE

To date, MTAS declaration has insufficiently promoted the LTIE (if it has done so at all) due to an inability or unwillingness on the part of the ACCC to address the lack of retail FTM pass through. In deciding on how to best make an FAD for the MTAS that promotes the LTIE, it is not sufficient for the ACCC to simply do 'half the job' i.e. set a price and hope the market does the rest (even where it has failed to do so to date). Rather, it must use all of the regulatory tools in its tool-box to mandate an outcome which completes the job. If it is not able to do this it should refrain from further regulatory intervention on the MTAS rate.

The following table shows a selection of Telstra's residential fixed line plans from 2003[8] and 2014.[9] We believe it is clear that end-users have not adequately benefited from off net fixed to mobile MTAS price reductions. Whatever price reductions have occurred (and this is minimal) has been taken away from consumers via substantial line rental price increases:

[8] Telstra (2003), *A handy guide to home communications* (see Attachment A).

[9] Telstra (2014), 'Home phone plans', https://www.telstra.com.au/home-phone/plans-rates/index.htm#get, September.

2003	**2014**
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* Capped at $2 for the first 20 minutes per call.

To date, the ACCC's regulation of MTAS has resulted in very limited benefits to consumers because Telstra has not fully passed on the reductions in MTAS prices over the past ten years. As previously noted, this lack of pass through of FTM prices has been a significant contributor to Australia's enduring flawed market structure, damaging competition in both the fixed and mobile markets.[10]

This view is hardly new. It was cogently expressed in the Analysys Mason report commissioned by the ACCC on the *'Regulatory treatment of fixed-to-mobile passthrough'* (2009) (**Analysys Mason Report**)[11] and the Frontier

[10] VHA, '*Declaration of the Domestic Mobile Terminating Access Service - Response to the ACCC*', 5 July 2013, page 2

[11] Analysys Mason, '*Regulatory treatment of fixed-to-mobile passthrough*' 2009

Economics report commissioned by VHA which extended the welfare analysis of past reductions in MTAS undertaken by Analysys Mason (**Frontier Economics Report**)[12].

In the former, the ACCC's own expert stated:

- that the absence of regulation of FTM pass through in selected international benchmarked countries has led to ***quite high and increasing retention margins***[13] in a number of those countries, with the resulting FTM retail margins being comparable to those seen in Australia (emphasis added);
- regulating FTM pass through would have a positive impact on overall social surplus;
- regulating MTAS also increases the overall social surplus; and
- while regulating FTM pass-though and MTAS decreases the combined surplus for MNOs, this is more than compensated by the increase in consumer surplus.

Put simply, this means that regulating FTM pass through would promote the LTIE.

Yet, the ACCC has failed to adequately consider and respond to these reports. The ACCC has refused to engage and undertake any considered economic assessment of the issue of pass through despite its centrality to the statutory objective of promoting the LTIE. VHA urges the ACCC to commission an updated report to determine whether these conclusions still apply in light of the significant developments in fixed and mobile telecommunications markets.

Declaration of MTAS will not promote the LTIE unless the ACCC ensures that MTAS reductions are passed through to FTM end users. Without actual pass through, MTAS reductions will only strengthen Telstra's fixed line monopoly to the detriment of competing MNOs. This damages mobile services competition to the detriment of end-users.

This detriment will be further compounded as a result of the concerns the ACCC recently expressed regarding NBN Co payments to Telstra in its discussion paper on its FAD inquiry on primary prices for fixed line services.[14] VHA echoes the ACCC's concerns that Telstra, as an integrated operator, could benefit from the NBN Co payments

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[12] Frontier Economics, *'Welfare analysis of implications of reduced mobile termination rates'*, July 2011

[13] FTM retention is the difference between retail FTM call rates and wholesale mobile termination rates. It is composed of the fixed operator's own costs (origination and interconnection network costs, retail costs) and its margin.

[14] ACCC, *'Public Inquiry into Final Access Determinations for Fixed Line Services – Primary Price Terms Discussion Paper'*, July 2014

and lead to a distortion of market outcomes. In this environment, the need for the ACCC to appropriately regulate the market is even greater.

2.2 ACCC's recognition that lack of pass through is a serious problem

Ironically, despite its inaction, the ACCC has consistently recognised that pass through is important in promoting the LTIE:

> *"The ACCC acknowledges that the pass-through of MTAS price reductions to end-users is an important consideration in assessing whether the declaration will promote the LTIE …"*[15]

This was also acknowledged by the ACCC in its pricing determination in 2009, where it stated that:

> "*the ACCC is disappointed with respect to reductions in retail FTM prices, as it appears no significant reduction in retail FTM prices has emerged despite earlier expectations*."[16]

The ACCC further stated that:

> *"while the ACCC appreciates that there are other costs associated with delivering FTM services and that MTAS cost savings can be passed through via reductions in the bundle of pre-selected fixed line services, the Commission is of the view that the degree of pass through to FTM retail prices remain lower than could be expected given the reductions in MTAS prices."*[17]

2.3 ACCC's current lack of engagement on pass through

Despite this previous recognition of the lack of retail FTM pass through, the ACCC seems now to be less likely than ever to properly address the issue of pass through. Indeed, VHA wonders whether the ACCC has pre-judged the issue to a significant extent. We simply cannot understand how the ACCC's assessment has determined MTAS price reductions are warranted when the table comparing Telstra's 2003 and 2014 home phone plans clearly shows that Telstra's FTM price points have barely changed and subscription charges and margins have substantially increased.

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[15] ACCC, *'Domestic Mobile Terminating Access Service Declaration Inquiry –ACCC's Final Decision'*, June 2014, paragraph 6.2

[16] ACCC, *'Domestic Mobile Terminating Access Services Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011'*, March 2009, page 22

[17] ACCC, *'Domestic Mobile Terminating Access Services Pricing Principles Determination and indicative prices for the period 1 January 2009 to 31 December 2011'*, March 2009, page 24

The ACCC in its Draft Declaration Decision[18] and its Final Declaration Decision[19] stated that it will consider the issue of pass through in its MTAS FAD inquiry. Despite the promise of further consideration, VHA is extremely concerned that the ACCC appears to have pre-judged this issue in the Discussion Paper[20] (as well as in its Final Declaration Decision).[21] In both instances, the ACCC referred to data comparing average FTM prices and MTAS rates from 2005-6 to 2012-13. The ACCC has interpreted the data as showing that in total, there has been a reduction in the average MTAS rate of 14.10cpm and a reduction in average FTM revenue of 11.77cpm. The ACCC also compared changes in FTM revenues and savings in MTAS payments from 2005-06 to 2012-13.

Based on that data, the ACCC concluded that *"Telstra's average retail FTM call rate have* [sic] *consistently fallen"* and that "*accumulated reductions in FTM call revenue have been greater than the accumulated reductions in the MTAS rate*".[22] However, an analysis of the ACCC's data, which formed the basis of the ACCC's view at page 22 of the Discussion Paper below, reveals that the trends in FTM call rate reductions have no correlation to MTAS rate reductions (see **Figure 1**).

[18] ACCC, *'Domestic Mobile Terminating Access Service Declaration Inquiry – Report of the ACCC's Draft Decision'*, 13 December 2013 (Draft Declaration Decision), paragraph 2

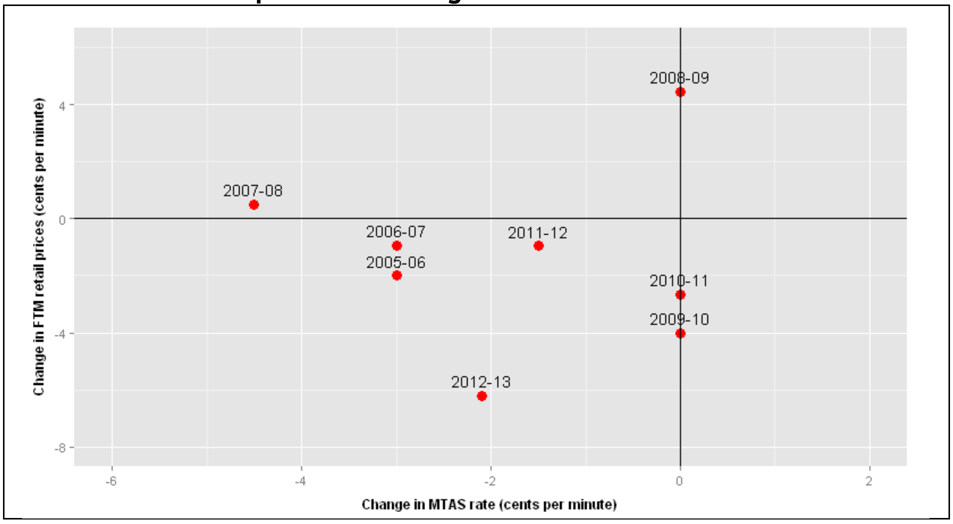
[19] ACCC, *'Domestic Mobile Terminating Access Service Declaration Inquiry –ACCC's Final Decision'*, June 2014 (Final Declaration Decision), page 28

[20] Discussion Paper, page 22

[21] ACCC, *'Domestic Mobile Terminating Access Service Declaration Inquiry –ACCC's Final Decision'*, June 2014, page 28

[22] Discussion Paper, page 22

Figure 1: Plot of the ACCC's data on changes in average retail FTM call prices and changes in the MTAS rate



Source: ACCC (2014), *MTAS FAD discussion paper on pricing approaches*, August, p22.

The level of analytic consideration given by the ACCC to FTM pass through in the Discussion Paper is cursory at best. The ACCC has not pointed to any reliable evidence that pass through has occurred since its pricing determination in 2009. Such an approach would not stand up to judicial scrutiny nor would it be sufficient in any other context (such as an ACCC merger review). It is unacceptable for the ACCC to conclude that FTM pass through is possible without determining whether pass through has actually occurred.

VHA acknowledges that it is difficult to determine the level of pass through when FTM calls are often bundled with other fixed line services (however given the price points for FTM have barely changed this assessment is not really necessary). This view is also shared by the ACCC as indicated in its Discussion Paper that "*a review of average FTM prices over time is not definitive of the extent to which savings from falling regulated rates are passed on in retail prices and services. There will, for example, be other factors which affect the level of retail FTM prices, such as the costs of origination and transmission need to provide FTM services.*"[23]

Despite the difficulties observed, the ACCC proceeds to effectively conclude that it is sufficient that pass through **may have** occurred. This approach is fundamentally flawed and contrary to the requirement that the ACCC be 'affirmatively satisfied' of the matters stipulated by the CCA.[24] The ACCC cannot simply assume that pass through

[23] Discussion Paper, page 23

[24] Application by Optus Mobile Pty Limited and Optus Networks Pty Limited [2006] ACompT 8, paragraph 9

has occurred (in ways that the ACCC cannot identify) because *"Telstra **may have** passed through reductions in the MTAS rate in other ways"*[25] (emphasis added).

The ACCC should not be satisfied that the LTIE is promoted merely because pass through **may** occur or **may have** occurred without determining whether pass through **has** actually occurred. The ACCC has a responsibility, and the ability, to forensically examine whether pass through has **actually** occurred. It has statutory powers which it frequently uses in other contexts to inform itself of issues of this kind. Why is it unprepared to do so here? It is incumbent on the ACCC to improve the quality of its analysis and provide evidence to demonstrate the facts being asserted.

3. No reduction of MTAS pricing

Despite many years of the ACCC implementing cost-based MTAS regulation for the MTAS, the anticipated competition and consumer benefits have been disappointing at best. At worst, past MTAS pricing decisions have been detrimental to the LTIE. For this reason, the ACCC should contemplate new and different approaches to regulatory pricing for the MTAS.

3.1 MTAS pricing for voice

VHA considers that there is no basis for the ACCC to further reduce MTAS pricing for voice. As the ACCC notes, the current level of regulated MTAS is already low[26] and whilst the ACCC's view is that the cost per minute of providing mobile voice termination services "is likely to have reduced" since the 2011 MTAS FAD inquiry, the ACCC does not provide any evidence that this is in fact the case.[27]

This position is also supported by the ACCC's own high level cursory consideration of international benchmarking, which suggests that the current MTAS pricing of 3.6cpm is within the acceptable range internationally and not sufficiently different to warrant a change.

The ACCC should therefore exercise great caution when deciding whether to alter the MTAS pricing.

The ACCC should only alter the MTAS pricing for voice if the new regulated price is based on a credible cost model which allows for a rigorous, evidence based approach to regulatory decision-making. To do otherwise would be clearly contrary to the legitimate businesses interests of access providers as well as discouraging efficient

[25] Discussion Paper, page 23

[26] Discussion Paper, page 18

[27] Discussion Paper, pages 7, 9

investment in infrastructure by denying access providers' legitimate expectation of cost recovery on their investments.

If, despite the concerns raised by VHA, the ACCC is minded to making changes in the MTAS rate, there is merit in exploring whether FTM MTAS and MTM MTAS should be treated differently for pricing purposes. As the ACCC recognises, the downstream markets for origination of MTAS traffic are distinct. For instance, MTM traffic is relatively balanced between MNOs and interconnection arrangements are broadly symmetric. As such, VHA does not have a concern with the ACCC moving to a cost-based price for MTM traffic. By contrast, reductions in the rate of MTAS for FTM calls, which are then not fully passed on to consumers in the form of lower retail FTM prices, create a windfall gain for Telstra. This has a detrimental impact on competition within telecommunications market.

We consider it deeply problematic for the ACCC to contemplate a reduction on MTAS for FTM calls when the only beneficiaries of past reductions in the price of the MTAS have been FNOs, of which Telstra would be the most significant.[28] It is contrary to the ACCC's statutory objectives to make a decision to lower MTAS for FTM calls when its primary effect is to enrich Australia's most profitable telecommunications company.

3.2 MTAS pricing for SMS

VHA continues to consider that SMS termination should not have been declared.[29] It follows that VHA does not consider it necessary (or appropriate) to specify SMS termination charges in the FAD at this stage.

VHA maintains that SMS technology is 'old world' technology and is rapidly being taken over by smartphone messaging applications better known as 'social messaging.'[30] As previously submitted, smartphone penetration has increased rapidly over the past few years and by June 2014, VHA expects it to have reached over 70% of Australians.[31] In late 2013, it was predicted that global SMS revenues will decline after 2016. In a report by Ovum dated November 2013, it is estimated that "*that global SMS and MMS revenues will peak within two years and begin to decline from 2016 onward. The slowdown and subsequent decline in messaging revenues will result from the increasing popularity of social messaging applications. These services have already begun to eclipse*

[28] Frontier Economics (2011), *Welfare analysis of reduced mobile termination rates*, Prepared for VHA, July.

[29] VHA, '*MTAS Declaration Inquiry, Supplementary Submission to the ACCC*, April 2014, page 1

[30] For example, Whatsapp, Viber, Kik and Facebook Messenger.

[31] VHA, '*MTAS Declaration – Submission in response to the ACCC's Draft Decision*', 2014, page 11

traditional SMS, and relegate it to a bearer technology for mobile services."[32] The lost SMS revenues due to social messaging were estimated to be $32.6 billion in 2013 alone.[33]

SMS termination prices are currently agreed through commercial negotiations between mobile network operators MNOs in an already competitive market. Accordingly, the ACCC must exercise extreme caution when deciding whether, and how, to set regulated SMS termination prices.

The main practical reason why determining a regulated SMS termination price is unnecessary is because traffic flows are largely balanced and so the price of termination does not influence the overall cost of providing the service (ie the cost of terminating traffic on other networks is countervailed by the revenue received from calls terminated from other networks). This means that the SMS termination price has little bearing on the wholesale and retail price for SMS's. Having said this we recognise the ACCC's concern that the market price for SMS termination has not changed for many years. To avoid unnecessary regulatory red tape we believe that a 'light touch' approach to pricing for SMS termination is warranted. As advised in our previous submissions we are prepared to commit to undertaking commercial discussions that will reduce the SMS termination price. The ACCC should provide the industry nine months to reduce the termination price closer to international benchmarks.

If the ACCC does contemplate setting a regulated SMS termination rate, the ACCC ought to also consider the potential for unintended consequences. For instance, an extremely low SMS termination rate may lead to an increase in SMS spam to consumers. As with voice termination, the ACCC should be informed by a robust cost model in determining the SMS termination price however this should not be the sole criteria the ACCC's uses to make its final decision.

4. MTAS pricing methodology

If, despite the matters referred to above, the ACCC is minded to alter MTAS pricing for voice or set a regulated price for SMS, VHA at least welcomes its acknowledgment that it needs to dispense with the WIK Model, which is now clearly outdated.[34]

In the event that the ACCC decides to materially alter the current MTAS pricing for voice or set a regulated price for SMS, the ACCC must conduct a thorough analysis involving the development of at least one cost-based model for stakeholders to consider. To do otherwise would run a significant risk of regulatory error, particularly given the inherent limitations of a benchmarking approach, and would fail to take account of the statutory criteria being the

[32] Ovum, *Analyst Opinion: Global SMS revenues will decline after 2016*, 11 November 2013

[33] Ovum, *Analyst Opinion: Global SMS revenues will decline after 2016*, 11 November 2013

[34] Discussion Paper, page 12

matters set out in section 152BCA(1) of the *Competition and Consumer Act 2010* (**CCA**). These include consideration of whether the FAD will promote the LTIE, the legitimate business interests of a service provider, interests of persons who have a right to use the service, direct costs of providing access, extensions or enhancements of capability, safe and reliable operation and economic efficiency. Consistent with the ACCC's view, VHA considers that "an overall objective in this part of the FAD inquiry is to determine an efficient price for the provision of the MTAS in accordance with criteria under the CCA."[35]

In the absence of a reliable and robust cost model, the ACCC should not change current MTAS pricing. In the event that the ACCC is unable to arrive at an appropriate pricing methodology, it would better promote the LTIE if the ACCC defer any further reductions in MTAS pricing.

It has also long been VHA's view[36] that the WIK model does not reflect 'market realities' or the practical realities which would be experienced by a new entrant rolling out a network in Australia. The outputs of the WIK model only provided a theoretical floor for 2G MTAS rates. They cannot be safely relied upon as an estimate of the efficient costs of supplying MTAS across networks combining 2G, 3G and 4G services, given the absence of actual cost information and the lack of accounting for market realities facing MNOs operating in Australia.

The ACCC has invited comments on alternative pricing methodology options for MTAS including:

- TSLRIC;
- TSLRIC+;
- pure LRIC;
- international benchmarking; and
- bill and keep (**BAK**).

VHA is of the view that the most appropriate cost-based pricing methodology for MTAS is a building block model (**BBM**) for the reasons set out below.

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[35] Discussion Paper, page 4

[36] Vodafone Australia Limited, '*Draft MTAS Pricing Principles Determination and Indicative Pricing for the period 1 January 2009 to 31 December 2011*', 16 December 2008, page 7

4.1 Preferred cost methodology

VHA considers that the most appropriate form of pricing methodology for MTAS is a BBM based on actual costs which will, in this case, almost certainly be efficient.

A BBM is to be preferred because it:

- is more likely to produce a result that reflects the direct costs of providing access to the service in accordance with section 152BCA(1)(d) of the CCA;
- is consistent with the ACCC's approach to pricing of other declared services, including other fixed line services (which is particularly desirable considering that Telstra is a key provider of both fixed and mobile services) and would be easy to adopt given the ACCC is already familiar with the methodology;
- is relatively more cost effective when compared to other pricing methodology options;
- allows the ACCC to separately consider the four critical elements in regulatory price setting: the asset base, operating costs, usage and pricing;
- permits the aggregation of the asset base and operating costs across the set of regulated services (rather than on a service-by-service). This is likely to substantially reduce the risk of regulatory error in allocating costs across all regulated services; and
- contains a forward looking component which is logical for setting future prices and reflects asset depreciation in a way that benchmarking cannot.

These benefits have been recently recognised by the ACCC in its discussion paper on the FAD on primary prices for fixed line services:

> *"The BBM is an established approach used to determine the revenue required by a regulated business and has been widely adopted by Australian regulators in other sectors. It allows the access provider to recover its efficient actual costs as well as a reasonable rate of return on, and a return of, its investment in existing sunk assets.*
>
> *Implementing the BBM requires establishing the initial value of the regulated business's regulator asset base (RAB). Once the initial value of the RAB is established, it is 'locked-in' and rolled forward from one year to the next.*
>
> *A principal advantage of adopting a BBM is that it improves certainty for both the access provider and access seeker relative to the TSLRIC+ approach. This is because it sets a value for the regulatory asset base (RAB) and a fixed method for updating the RAB value used to provide the declared services. This is in contrast to the continual revaluation of network assets and the calculation of forward looking costs providing the services using modern equivalent assets (MEA) that occurs under a TSLRIC+ approach. This enables access provider and access seeker to make efficient decisions regarding their future investment,*

which in turn promotes economically efficient investment in infrastructure. Other advantages of the BBM includes [sic] promoting predictable revenue and price paths and minimising the prospect of windfall gains and losses and ensuring that the access provider is adequately compensated for its costs over time." [37]

VHA agrees and encourages the ACCC adopt a similar approach for MTAS. Indeed, it is unclear why there would be any reason for the ACCC to adopt a different approach for MTAS than it uses for fixed line services.

However, there is one important distinction between fixed line and mobile markets which the ACCC must take into account in developing the BBM (or BBMs). The mobile services market is a competitive one with three MNOs of significant scale as well as a number of resellers and mobile virtual network operators. Therefore, it is a reasonable assumption for present purposes that each of those MNOs invests efficiently. Therefore, it is appropriate for the ACCC to collect data inputs from each MNO to construct the BBM. The ACCC should then use its discretion to determine the average or 'typical' efficient cost of supply the MTAS for participants in the Australian mobile services market.

4.2 TSLRIC and TSLRIC+

In the event that the ACCC decides not to adopt a BBM approach, VHA's next preferred option is a TSLRIC+ approach. Nevertheless, TSLRIC+ is a less suitable than BBM because:

- it is inconsistent with the ACCC's approach for fixed line services which is problematic given the need for allocation of common costs incurred by integrated fixed and mobile operators;
- it is unnecessary given the number of competing mobile infrastructure providers; and
- it is more costly and overly complex.

This was acknowledged by the ACCC in its discussion paper or MTAS Public Inquiry to make an Access Determination in 2011 citing *Application by Telstra Corporation Limited [2010] ACompT 1*[38]:

"The ACCC notes that when TSLRIC+ was first adopted as the preferred pricing methodology for the MTAS, mobile networks were predominantly 2G networks focused on delivering voice services.

[37] ACCC, *'Discussion Paper, Final Access Determination for Fixed Line Services', 2* July 2014, page 3

[38] Application by Telstra Corporation Limited [2010] ACompT 1, 10 May 2010, paragraphs 198-199

Current networks are being optimised for mobile data and undergoing another transformation to IP-based networks.

The ACCC notes recent regulatory events have cast doubt on whether continued application of TSLRIC+ pricing will best promote the LTIE beyond 2011. The Australian Competition Tribunal stated that TSLRIC+ is overly complex and has called for a 'simpler and more appropriate pricing methodology'. The international trend in terms of mobile termination pricing is also moving away from TSLRIC."[37]

A relatively simple BBM (or BBMs for each MNO) provides a solution to this problem.

4.3 International benchmarking – inadequate basis for new MTAS charges

VHA does not consider international benchmarking to be an adequate or appropriate basis for setting new MTAS pricing. An international benchmarking approach is inherently flawed because:

- benchmarking only accurately reflects true cost of supply between similar jurisdictions that are all effectively competitive - realistically, this is not the case for Australia and other jurisdictions;
- European Union (**EU**) jurisdictions adopt a pure LRIC approach to pricing, which is mandated by EU regulation, and differs significantly from the ACCC's preferred approach here. As a result (and because of blurred market boundaries) the voice termination charges in different countries in the EU lack the requisite degree of independence. Therefore EU jurisdictions cannot be used for benchmarking;
- New Zealand has already used benchmarking to arrive at its MTAS pricing and therefore lacks independence from the other observations; and
- comparisons with jurisdictions such as India and Brazil which do not take account of purchasing power parity or significant differences in population (which deliver operators in these countries scale benefits that are impossible to achieve here) Both jurisdictions include idiosyncratic adjustments to their regulated termination rates – for instance, India includes an "offsetting" approach whereby the costs of termination are arbitrarily reduced by value-added service revenue and Brazil includes a cost sharing methodology driven by the balance of interconnection traffic rather than the cost of termination. Both jurisdictions should be excluded from the dataset.

Similarly, the Australian Competition Tribunal (**ACT**) stated (which approach has been endorsed by the ACCC[39]) that:

> *"In order to place any reliance upon international benchmarking analysis it would be necessary to know much more about the regulatory environment within which they were determined, the state of the relevant markets and the socio-economic environment in which the mobile services were operative."*[40]

VHA considers that international benchmarking is only useful as a starting point to determine whether the current MTAS pricing should be changed. To that end, Australia's current MTAS voice pricing of 3.6cpm is not sufficiently different from relevant international comparators to warrant further reduction.

4.4 Bill and keep

In principle, VHA sees merit in a bill and keep (**BAK**) arrangements in certain circumstances (for example, where traffic flows are balanced and rates are symmetric). However, a BAK arrangement should not be implemented through regulation as it is inconsistent with the ACCC's desire for pricing to reflect the cost of providing a service. Also the practical issues of arbitrage and fraudulent activities also need to be considered.

5. Mobile market changes since the 2011 MTAS FAD

Currently, voice services are currently not offered over 4G networks though this will change during the term of the FAD. We therefore agree with the ACCC's assessment the services offered over 4G networks are relevant to its consideration. VHA has made significant investments in 4G technologies. If the ACCC determines a reduction in MTAS charges is warranted and undertakes to build a cost model then the model should reflect the substantial investment in 4G technologies, particularly if they are subsequently used to enable interconnection.

The mobile industry has also recently made large investments to renew spectrum licences. It will make further large investments during the term of the FAD to either acquire or renew spectrum licences. The capital investments in spectrum are much higher in Australia than they are in many other countries and much higher than the figures used in previous ACCC cost-modelling exercises for the MTAS. The ACCC must be mindful that international trends in termination pricing will not reflect Australia's high (and recently incurred) spectrum costs. To avoid cost under-recovery, the ACCC must explicitly acknowledge and address Australia's high capital costs for spectrum in any decision on the MTAS rate.

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[39] ACCC, '*Inquiry to make a final access determination for the MTAS – Draft Access Determination Explanatory Statement*', 23 September 2011, page 8

[40] *Application by Optus Mobile Pty Limited & Optus Networks Pty Limited* [2006] ACompT 8 (22 November 2006), paragraph 297

Finally, the ACCC must take into account Australia's unique geography, small market size and low population density to put purported "trends in termination pricing" in context. The ACCC cannot assume that cost trends for mobile site deployment or site upgrades in Europe will reflect cost trends in the Australian market.

6. Duration of regulated terms and conditions

VHA considers that a regulatory period of 5 years for primary prices is appropriate and consistent with the proposed declaration period for MTAS. As previously submitted,[41] any period of time less than a 3 year timeframe would subject businesses to a significantly higher risk profile in terms of potential costs and revenues. Certainty regarding accesses prices is desired to that they can be incorporated into the business' forecasting, strategic planning and business models.

7. Conclusion

In terms of promoting the LTIE, the declaration of MTAS has been a succession of aspirations, gambles and ultimately missed opportunities. The ACCC gambled that by continually reducing MTAS charges, it would promote pass through and consumers in uncompetitive fixed line markets would benefit. That gamble has clearly failed. However, this FAD presents an opportunity for the ACCC to say 'enough is enough' and use the tools at its disposal to ensure that declaration of the MTAS actually promotes competition and efficiency rather than giving the fixed line incumbent yet another source of retained earnings.

A mere hope that long-term interests of end-users are being met is not enough. The ACCC needs to observe the market and make its decisions accordingly.

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[41] Vodafone, *Draft MTAS Pricing Principles Determination and Indicative Pricing for the period 1 January 2009 to 31 December 2011*, 16 December 2008, page 21

Attachment A: Telstra (2003), *A handy guide to home communications*.